INDEX.

PAGE

PETITION FOR WRIT OF CERTIORARI:

Opinions Below 1
Jurisdiction 2
Questions Presented 2
Statement 2
Specification of Errors to Be Urged 4
Reasons for Granting the Writ 4

BRIEF:

POINT I—Petitioner should be allowed to file for the full amount of its claim of $10,739.94 because it is not a "secured creditor" as defined by Section 1 (23) of the Bankruptcy Act of 1898 [11 U. S. C. A., Section 1 (23)] for the reason that it does not have security for its debt upon the property of the bankrupt 6

POINT II—Section 68 (a) of the Bankruptcy Act of 1898 [11 U. S. C. A., Section 108 (a)], does not apply to the case at bar 18

TABLE OF CASES CITED:

Baker Lumber Co. v. *Clark Co. et al.*, 178 Pac. 764 (Utah S. C.) 4, 6, 12

Gorman v. *Wright*, 136 Fed. 164 (C. C. A. 4th) 4, 6, 19

Hampel et al. v. *Minkwitz*, 18 Fed. (2d) 3 (C. C. A. 5th) 4, 17

Hiscock v. *Varick Bank*, 206 U. S. 28 (United States Supreme Court) 8, 19

In re Headley, 97 Fed. 765 (D. C. Mo.) 4, 8, 18

In re Keep Shirt Co., 200 Fed. 80 (U. S. Dist. Ct. So. Dist. of N. Y.) 5, 10, 19

PAGE

In re Mertens et al., 144 Fed. 818 (C. C. A. 2nd) ..4, 7, 19
In re Noyes Bros., 127 Fed. 286 (C. C. A. 1st) 4, 9
In re Pan-American Match Co., 242 Fed. 995 (D. C. Mass.) 5, 9
In re Shqtz, 251 Fed. 351 (D. C. E. D. Pa.) 5, 8
In re Thompson, 208 Fed. 207 (D. C. N. Y.) 4, 8
In the Matter of Hanson & Tyler Auto Co., Bankrupt, 286 Fed. 161 (U. S. Dist. Ct., Iowa) 5, 16
In the Matter of the West Point Investment Co., Bankrupt, 19 A. B. R. (N. S.) 572 (D. C. Ga.)..5, 9, 21
Manufacturer's Acceptance Corp. v. Hale et al., 65 Fed. (2d) 76 (C. C. A. 6th) 4, 11
Matter of Anderson, 11 Fed. (2nd) 380 (D. C. Minn. 6th Div.) 4, 6
Thompson-Ritchie Grocery Co. v. Cary et al., 17 La. App. 270, 135 So. Rep. 707 (Ct. of Appeal La., 2nd Cir.) 5, 14
Young v. Gordan, 219 Fed. 168 (C. C. A. 4th) 4, 6

OTHER AUTHORITIES CITED:

Section 240 (a) of the Judicial Code, as amended by Act of Cong. February 13, 1925, c. 229, 43 Stat. 936 2
Bankruptcy Act of 1898 (11 U. S. C. A.),
Section 1 (23) 2, 6, 16, 19
Section 68 (a) 2, 4, 18, 19, 22
Section 108 (a) 2, 18
Collier on Bankruptcy (13th Edition),
Vol. 1, page 28 ..... 4, 6
Vol. 2, page 1144 .....4, 6, 7
Remington on Bankruptcy (3rd Edition),
Vol. 2, page 306, Sec. 917 ..... 4, 7
A. B. R. Digest No. 7 (N. S.) 1933-33, on page 382, Sec. 789 15
Colliers 1934 Supplement, page 393, subject (3) 15

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No.

THE IVANHOE BUILDING & LOAN ASSOCIATION OF NEWARK, N. J.,

Petitioner,

—against—

THOMAS A. ORR, Trustee of EASTERN SASH & DOOR COMPANY, Bankrupt,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MAY IT PLEASE THE COURT:

The petitioner, The Ivanhoe Building & Loan Association of Newark, N. J., respectfully prays that a Writ of Certiorari issue to review the decree of the Circuit Court of Appeals for the Third Circuit entered in the above case on October 3, 1934 (R. 24), affirming an Order of the United States District Court for the District of New Jersey (R. 11).

Opinions Below.

The opinion of the Circuit Court of Appeals is printed (R. 20-24) but is not yet reported. The opinion of the United States District Court for the

District of New Jersey is printed (R. 8-10). The order of the Referee in Bankruptcy is printed (R. 6-7).

Jurisdiction.

The decree of the Circuit Court of Appeals was entered October 3, 1934 (R. 24). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of Cong. February 13, 1925, c. 229, 43 Stat. 936.

Questions Presented.

1. Whether an unsecured creditor, not holding security upon property belonging to the bankrupt, may prove its entire claim against the bankrupt estate, without any deduction for the value of the security.

2. Whether Section 1 (23) of the Bankruptcy Act of 1898 [11 U. S. C. A. Section 1 (23)], or whether Section 68 (a) of said Act [11 U. S. C. A. Section 108 (a)] applies to the case at bar.

Statement.

The facts are not in dispute, and are contained in a "Stipulation of Facts" (R. 2-5), and are as follows:

On July 21, 1927, Abraham Portnoff and others executed to the petitioner a bond in the penal sum of $23,000 conditioned for the payment of $11,500, and to secure the payment thereof, said obligors executed to petitioner a mortgage on property known as No.

386 Leslie Street, Newark, New Jersey. On October 7, 1927, said property was conveyed to the bankrupt (R. 2), subject to said mortgage, which the bankrupt in the deed expressly assumed and agreed to pay. On the same day the bankrupt conveyed said property to one Clara Yavne, and she in the deed also expressly assumed and agreed to pay said mortgage (R. 3).

On April 2, 1932, the petitioner filed a Bill against all of said parties to foreclose said mortgage, and on June 20, 1932 a final decree was entered in the foreclosure proceeding, wherein it was decreed that there was due to petitioner, on the mortgage, the sum of $10,220.96, together with interest and costs. The property was sold by the Sheriff and was bid in by the petitioner for $100, leaving a deficiency on said bond in the sum of $10,739.94 (R. 3).

On April 23, 1932, the said Eastern Sash & Door Company, on an involuntary petition, was adjudicated a bankrupt, and on September 28, 1932 the petitioner filed its claim, as an unsecured creditor, for $10,739.94, being the difference between the sum found to be due on said mortgage and the $100 bid at the Sheriff's sale (R. 3-4).

It was admitted that the true value of the property at the time of the Sheriff's sale was $9000 (R. 4). The Referee ordered that the petitioner's claim be reduced to $1,739.94 (R. 6-7). On petition for review of the Referee's order, the United States District Court for the District of New Jersey affirmed the Referee's order (R. 11).

The petitioner thereupon appealed to the United States Circuit Court of Appeals for the Third Circuit, and the said Circuit Court affirmed the order of the District Court (R. 24).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that petitioner must reduce its claim by the admitted value of the security less the $100 paid for it.

2. In holding that said Section 68 (a) of the Bankruptcy Act of 1898 applies to the case at bar.

3. In affirming the Order of the United States District Court for the District of New Jersey.

Reasons for Granting the Writ.

1. The holding of the Court below is in conflict with the applicable decisions of other Circuit Courts of Appeals. *Gorman* v. *Wright,* 136 Fed. 164 (C. C. A. 4th); *Young* v. *Gordon,* 219 Fed. 168 (C. C. A. 4th); *In re Mertens et al.,* 144 Fed. 818 (C. C. A. 2nd); *In re Noyes Bros.,* 127 Fed. 286 (C. C. A. 1st); *Manufacturer's Acceptance Corp.* v. *Hale, et al.,* 65 Fed. (2d) 76 (C. C. A. 6th); *Hampel, et al.* v. *Minkwitz,* 18 Fed. (2d) 3 (C. C. A. 5th).

2. The Court below has decided an important question of general law in conflict with the weight of authority. Collier on Bankruptcy (13th Edition), Vol. 1, p. 28, also Vol. 2, p. 1144; Remington on Bankruptcy (3rd Edition), Vol. 2, p. 306, Sec. 917; *Baker Lumber Co.* v. *Clark Co., et al.,* 178 Pac. 764 (Utah S. C.); *Matter of Anderson,* 11 Fed. (2nd) 380 (D. C. Minn. 6th Div.); *In re Thompson,* 208 Fed. 207 (D. C. N. Y.); *In re Headley,* 97 Fed. 765 (D. C.

Mo.); *In re Shatz*, 251 Fed. 351 (D. C. E. D. Pa.); *In the Matter of West Point Investment Co., Bankrupt*, 19 A. B. R. (N. S.) 572 (D. C. Ga.); *In re Pan-American Match Co.*, 242 Fed. 995 (D. C. Mass.); *In re Keep Shirt Co.*, 200 Fed. 80 (U. S. Dist. Ct., So. Dist. of N. Y.); *Thompson-Ritchie Grocery Co.* v. *Cary, et al.*, 17 La. App. 270, 135 So. Rep. 707 (Ct. of Appeal La., 2nd Cir.); *In the Matter of Hanson & Tyler Auto Co., Bankrupt*, 286 Fed. 161 (U. S. Dist. Ct., Iowa).

3. The Court below has decided an important question of Federal law which has not been, but should be, settled by this Court.

WHEREFORE, your petitioner respectfully urges that the instant petition should be granted, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Respectfully submitted,

MAURICE J. ZUCKER,
Counsel for Petitioner.

BRIEF.

POINT I.

Petitioner should be allowed to file for the full amount of its claim of $10,739.94 because it is not a "secured creditor" as defined by Section 1 (23) of the Bankruptcy Act of 1898, [11 U. S. C. A. Section 1 (23)] for the reason that it does not have security for its debt upon the property of the bankrupt.

The Bankruptcy Act of 1898, Sec. 1, Subd. 23 [11 U. S. C. A. Section 1 (23)] reads as follows:

> "'Secured creditor' shall include a creditor who has security for his debt upon the property of the bankrupt of a nature to be assignable under this Act, or who owns such a debt for which some indorser, surety, or other persons secondarily liable for the bankrupt has such security upon the bankrupt's assets."

The above section *defines* the two classes of creditors, the "secured" and the "unsecured", and a "secured" creditor is one who *has* security for his debt upon the *property of the bankrupt*, owned by the bankrupt *on the date of adjudication*, of a nature such that it will *pass to the Trustee in bankruptcy;* or who is secured by the obligation of another who holds such security; and all others are "unsecured." Collier on Bankruptcy (13th Edition) Vol. 1, page 28, also Vol. 2, page 1144; *Gorman* v. *Wright*, 136 Fed. 164 (C. C. A. 4th); *Young* v. *Gordon*, 219 Fed. 168 (C. C. A. 4th); *Baker Lumber Co.* v. *Clark Co., et al.*, 178 Pac. 764 (Utah S. C.); *Matter of Anderson*, 11 Fed. (2nd) 380 (D. C. Minn. 6th Div.).

The petition in bankruptcy herein was filed and adjudication made on April 23, 1932. *At that time* the bankrupt *was not the owner of the property* on which petitioner held a mortgage, bankrupt having sold said property to one Yavne on October 11, 1927 (R. 3).

Petitioner is, therefore, an "unsecured" creditor.

The rule that where the property held as security for a debt *is not the property of the bankrupt at the time of adjudication,* the claim should be allowed *in full without any deduction for the value of the security,* has been frequently enunciated and followed by the text writers and the Courts.

Remington on Bankruptcy (3rd Edition), Vol. 2, page 306, Sec. 917, says that:

> "Where the property held as security *is not the property of the bankrupt,* the claim should be allowed *without deduction* for the value of the securities." (Italics ours.)

Collier on Bankruptcy (13th Edition), Vol. 2, page 1144, says that:

> "The question pertains in each case to the security which a creditor *has* upon the property of the bankrupt. No matter how great may be the security which one may have, if it be property of *another* than the bankrupt, the creditor may prove his *entire* claim against the bankrupt estate, and receive a dividend thereon, and thereafter institute proceedings to enforce his claim upon the security for the balance." (Italics ours.)

In re Mertens et al., 144 Fed. 818 (C. C. A. 2nd). Creditor of bankrupt held as collateral, property of

one of the individual partners. The Court said, on page 820:

> "* * * The provisions of the present Bankrupt Act requiring secured creditors to surrender preferences, and when the security is not preferential to have its value determined as a condition precedent to the allowance of the claim, *have no application to cases in which the security was not the property of the bankrupt.*" (Italics ours.)

Hiscock v. *Varick Bank*, 206 U. S. 28 (United States Supreme Court), affirms the *Mertens* case above.

In re Thompson, 208 Fed. 207 (D. C.—N. Y.). Bankrupt was indorser on a note. Maker of note deposited with creditor certain shares of stock, not belonging to bankrupt, as collateral security. The Court said, on page 208:

> "* * * the words 'secured creditor', for the purposes of the administration of the bankrupt's estate, are limited to security *out of or against the estate*, * * *." (Italics ours.)

In re Heddley, 97 Fed. 765 (D. C. Mo.), it was held that where a judgment is recovered against two co-defendants, and execution thereon is levied upon the property of one of them, and the other is adjudged bankrupt, the judgment creditor may prove his claim against the bankrupt as unsecured.

In re Shatz, 251 Fed. 351 (D. C. E. D. Pa.), the Court said, at page 354:

> "The definition of a 'secured creditor' is a creditor who *directly holds* as security for his

> debt property *which would otherwise swell the assets of the bankrupt estate,* * * *." (Italics ours.)

In the *Matter of West Point Investment Co., Bankrupt,* 19 A. B. R. (N. S.) 572 (D. C. Ga.), Bankrupt was indorser of notes. Creditor held as collateral, bonds of the maker of the notes, a company in which bankrupt was owner of the majority stock and the company was indebted to bankrupt in excess of the creditor's claims. The Court said, at page 578:

> "* * * It seems to be the consensus of the opinion of the courts that the meaning of 'secured creditors' in Sec. 1 of the Act means that the security that is collateral to the claim *is the property of the bankrupt* and not of a third party * * *."

In re Noyes Bros., 127 Fed. 286 (C. C. A. 1st). Bankrupt was maker of notes indorsed by bankrupt and its treasurer individually, said individual having put up certain collateral security. The Court said, at page 287:

> "It is too late to go to the reason of the rule which permits a creditor whose claim is secured or partly paid by an accommodation indorser to prove the claim to its full amount, and exclude from the bankrupt estate the avails of such security or part payment, because the authorities in this country and England establishing that rule are such that we feel we ought to be governed by them."

In re Pan-American Match Co., 242 Fed. 995 (D. C. Mass.). Bankrupt was maker of note indorsed by third persons. The indorsers put up collateral security. The collateral and the indorsements were of

sufficient value to make payment of the note practically certain. Yet the Court said, at page 996:

> "A creditor's claim may be amply secured, but he is not a 'secured creditor' within the meaning of the Act unless the security is on 'property of the bankrupt.' The reason for such a rule probably is that, when no property of the bankrupt is held as security, the claim is, as to the estate, an unsecured one and may eventually be so presented against it * * *."

The following two cases amplify and strengthen petitioner's contention that no credit need be given for the value of the property in question.

In re Keep Shirt Co., 200 Fed. 80 (U. S. Dist. Ct.—So. Dist. of N. Y.), the facts were as follows: A sold to the bankrupt a bill of goods, payment of which B guaranteed. Later when A pressed B for security B gave him a note of the bankrupt arising upon a separate transaction. Then followed the bankruptcy and A sought to prove upon both claims. The referee allowed proof upon the note in full and upon the bill of goods less the dividend declared on the note. A insisted upon dividends in full on both. The Court said at page 80:

> "The theory of the referee is that as A held the note as security, the dividend must be deducted from the face of the bill of goods, because the dividend constitutes the value of the security (Sec. 57). This would be true enough if the bankrupt had given the security, *but it was not the bankrupt, but a surety of the bankrupt, who gave it.* Thus, if a surety gives property of his own as security to the creditor, it will not inure to the principal's interest, and

if the creditor realize upon it the surety is subrogated as though he had paid." (Italics ours.)

Again on page 81, the Court said:

> "The original error arises from regarding the security as a fund which should exonerate the estate. The statute does not so regard it *unless it be a part of the bankrupt estate itself* (Sec. 1, subd. 23), and the law is well settled that a surety's security does not exonerate the estate. *Re Noyes* (C. C. A., 1st Cir.), 11 A. B. R. 506, 127 Fed. 286, 62 C. C. A. 218; *Re Mertens* (C. C. A. 2nd Cir.), 15 A. B. R. 701, 144 Fed. 818. The referee appears to have been misled into supposing that because the note was made by the bankrupt it was a part of the bankrupt's property. Of course it never was, but was a part of the surety's property. It became security only after he delivered it as a part of his property. Order reversed, both claims to stand in full." (Italics ours.)

In the case of *Manufacturer's Acceptance Corp.* v. *Hale et al.*, 65 Fed. (2d) 76 (C. C. A.—6th), decided in 1933, the claimant held bankrupt's trust deed securing claimant's loan and all other claims of claimant. Claimant purchased bankrupt's unsecured note from a bank shortly before the bankruptcy petition was filed. The claim on the note was allowed as an unsecured claim and the Court said, at page 77:

> "* * * The note in the hands of the bank was unsecured. Its transfer to the appellant added nothing to the bankrupt's assets, nor was its status as an unsecured debt in any way affected by the transfer * * *."

In the case at bar, when the bankrupt purchased the mortgaged premises and assumed payment of the mortgage, it became the principal debtor. When the bankrupt sold the mortgaged premises to Yavne, who also assumed payment of the mortgage, Yavne then became the principal debtor and the bankrupt and the original obligors became sureties. Therefore, on the date of adjudication herein, the bankrupt was a surety and petitioner herein held its mortgage security upon property of the principal debtor (Yavne), a situation similar to the situations in the cases cited, which clearly hold that the value or proceeds of collateral belonging to the principal debtor need not be deducted from the claim against the bankrupt surety. So here, the property belonged to the principal debtor (Yavne) and the value of the same need not be deducted from the claim against the bankrupt surety.

In all of the above cited cases the claims were allowed in full as unsecured. And, the fact that the bankrupt herein was the owner of the property in question several years prior to adjudication is immaterial, which contention the following cases sustain.

Baker Lumber Co. v. *Clark Co. et al.*, 178 Pac. 764 (Utah S. C.). The defendant, Clark Co., made a contract with a school district for the construction of a school, and thereafter assigned to a bank moneys to become due on said contract. Thereafter Clark Co. was adjudicated a bankrupt. The defendants, Ellison and Strong, had claims against the bankrupt for labor performed or materials used in the construction of the school. Complaint prayed that plaintiff and defendants be adjudged to have a prior and superior claim to the fund due from the school district as against the bank. So held and bank appealed. Ellison and Strong had filed proof of their respective

claims in the bankrupt estate as unsecured debts and had received two dividends. It was insisted that the act of so proving their respective claims without reserving the right of enforcing such claims against any security held or to which they were entitled was a waiver against such security and constituted an election to pursue their remedy in the bankruptcy proceedings alone.

The Court said, at page 769:

> "It will be remember that A. A. Clark Co. had assigned all amounts coming to it from the school district to appellant bank shortly before entering into the contract with the school district, and had carried that assignment into effect by delivering the warrants to the bank. *It will thus be seen that at the time of the adjudication in bankruptcy the Clark Co. did not own or have any interest in the fund owing by the school district.* The defendants Ellison and Strong did not therefore, *at the date of such adjudication,* hold any security or claim against the property of the bankrupt. Neither were they secured by the obligation of any one holding such security. They were not secured creditors within the definition quoted, and it was not error to allow judgment against the fund in question for the amount due these claimants * * *." (Italics ours.)

Thus the above case presents a situation where at one time, *prior* to adjudication, the bankrupt had an interest in a fund, which fund stood as security in favor of Ellison and Clark, but that *prior* to the time of adjudication the bankrupt had assigned its interest in said fund. This is similar to the situation in the case at bar, as the bankrupt herein had *at one*

time been the owner of the property in question, but *prior* to the time of adjudication had sold said property.

The case of *Thompson-Ritchie Grocery Co.* v. *Cary et al.*, 17 La. App. 270, 135 So. Rep. 707 (Ct. of Appeal La.—2nd Cir.), decided in 1931, is practically on all fours with the case at bar. On June 30, 1923 plaintiff secured a judgment against S for $472.96 plus interest, which judgment was recorded in the mortgage records and operated as a judicial mortgage on all real property owned by S at the time or subsequently acquired. When plaintiff obtained and recorded the judgment, S was the owner of and in possession of "Blackacre". On April 26, 1924 S sold "Blackacre" to C and on April 12, 1926 C sold an undivided half interest in it to E. In 1927 S filed a petition in bankruptcy and in the early part of 1928 he was adjudicated a bankrupt and all of his property was surrendered and sold and the proceeds distributed among his creditors by the Bankrupt Court. Plaintiff filed his claim in those proceedings and received $94.43 on March 22, 1929, after filing of the suit at law. The suit at law was filed by plaintiff against C and E to collect plaintiff's judgment against S out of the property which he owned at the time the judgment was secured, but which is now owned by C and E. C contended that plaintiff was estopped from pursuing the property because it had filed its claim against S in the bankruptcy proceedings and sought to participate in the bankrupt's estate. The Lower Court entered judgment for the plaintiff, ordering defendants to surrender "Blackacre" to be sold to satisfy plaintiff's debt less amount recovered from the Bankrupt Court. Affirmed by Court of Appeal.

The Court said, at page 709:

> "* * * In all references to property securing a claim against a bankrupt both by the bankrupt act and the authorities, *only property belonging to the bankrupt's estate is included.* We have engaged in the above discussion to show that, even in cases where the law designates the order in which a secured creditor should proceed, it directs that he either proceed first against the security, or ascertain its value before being allowed to share in dividends accruing from the rest of the property. To sustain the exceptions of prematurity would be to hold directly opposite to what the law provides. But in this case the security out of which the plaintiff is endeavoring to collect its debt *is no longer the property of the original debtor, nor is it a part of the bankrupt's estate.* For that reason, the bankrupt court does not govern plaintiff in its efforts to collect its debt out of the said property, *nor is said property in any sense a part of the bankrupt's estate.* Under the law, plaintiff had a perfect right to participate as an unsecured creditor in the bankruptcy proceedings, without reference to the security held, *for the reason that the property held as security is not property of the bankrupt.*" (Italics ours.)

Although the above two cases were not decided in Federal Courts they are cited in the A. B. R. Digest No. 7 (N. S.) 1931-33 on page 382, Sec. 789 under the subject "Creditor holding security against third persons", and are also cited in Colliers 1934 Supplement, page 393 under the subject "(3) Claim secured by other fund or estate or by third party", and as they are the decisions of Courts of Appeal, they lend great support to petitioner's contention.

To respondent's contention that if bankruptcy had not intervened, petitioner, in a deficiency suit against the bankrupt, would be obliged to credit the value of the property against a deficiency, we respectfully submit that, while it is true that the Courts of New Jersey, as well as of many other States, have, during the present economic emergency, relaxed the strict application of their rules and have given unusual relief in deficiency suits, the respondent herein is not in a position to claim any benefit therefrom nor does this change the situation in the instant case. Long before the present emergency it was the settled rule in the Federal Courts and under the Bankruptcy Act that a creditor holding securities must credit the value thereof against his claim, and that a creditor holding a bond secured by a mortgage, must credit the true value thereof against the deficiency regardless of the sale price at the Sheriff's sale. *But the authorities are all in accord that these rules have no application where the bankrupt is not the owner of the property at the time of adjudication and that in such case no credit need be given for the value of the security. The Bankrupt Act Sec. 1 (23) controls.* The authorities I have cited clearly bear this out.

That petitioner is entitled to prove the *full amount* of its claim is further borne out in the following cases:

In the *Matter of Hanson & Tyler Auto Co., Bankrupt,* 286 Fed. 161 (U. S. Dist. Ct., Iowa), petitioner filed an unsecured claim based on promissory notes of bankrupt. One Christian, who had guaranteed bankrupt's indebtedness to petitioner, filed a claim based upon payment to petitioner of the amount of the guaranty, which was less than the amount of the indebtedness due from bankrupt to petitioner.

The Court said, at page 162:

> "* * * In the instant case petitioner, who was the original creditor guaranteed, was not paid his full claim, but only a part, and so far as appears from the record, were he permitted to receive the dividends upon the full amount of his original claim, *there would still be a balance unpaid.* In such circumstances to reduce petitioner's claim to the extent of the guaranty paid and permit the guarantor to prove for the amount so paid *would deprive petitioner of a part of his security and impair the obligation of his contract with the guarantor.*"
>
> * * * * * * * *
>
> "* * * here the party guaranteed *is not yet made whole,* and, as before stated, to permit the guarantor to assume 'the shoes' of petitioner, while petitioner is still bearing a loss, would be to deprive petitioner of the benefit of his contract." (Italics ours.)

Again on page 163, the Court said:

> "* * * In the opinion of the Court the referee erred in his conclusion and order, and should have allowed petitioner's claim and paid the full dividend thereon and disallowed the claim of Christian. Of course, in case the dividend received by petitioner, plus the amount already paid by the guarantor should over pay petitioner, it would leave the surplus held by petitioner as trustee for Christian, and he could recover same in a proper proceeding."

In the case of *Hampel et al.* v. *Minkwitz,* 18 Fed. (2d) 3 (C. C. A.—5th), sureties on a bond of the bankrupt partnership had paid part of the obligation and

it was contended that the sum paid should be deducted from the claim. The Court held that the claimant was entitled to dividends upon the full amount of the claim *"until from all sources he has received full payment."* (Italics ours.)

In re Headley, supra, the creditor held a judgment against the bankrupt and one Coover, and levied upon the stock of Coover and then filed the claim in bankruptcy for the full amount, which the Court allowed. The Court said, at page 771:

> "As the creditor's claim exceeds $12,000 and the alleged claim against Coover is $4,500, *it is hardly probable that his dividend out of the bankrupt's estate in any event would cover the difference."* (Italics ours.)

Petitioner is, therefore, entitled to dividends upon the full amount of its claim.

POINT II.

Section 68 (a) of the Bankruptcy Act of 1898 [11 U. S. C. A. Section 108 (a)], does not apply to the case at bar.

The above section provides that:

> "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

It will be observed that the above section is for the first time invoked in the case at bar by the Circuit Court of Appeals. Up to that time no mention was even made of Section 68 (a) nor did respondent rely upon the provisions thereof.

It is respectfully submitted that in holding that petitioner equitably owed the bankrupt the value of the security, and that Section 68 (a) therefore applies to the instant case, the Circuit Court of Appeals was in error, for the reason that *Section 68 (a) has no application where, as in the case at bar, the bankrupt was not the owner of the property on which petitioner held security.*

A careful search of the authorities has been made to find a case similar to the instant case, in which Section 68 (a) has been applied, but none was found. In all of the cases read, and in those already cited, in which the creditor did not hold security on property belonging to the bankrupt, the Courts applied Section I (23) of the Bankruptcy Act and not Section 68 (a), under the apparent theory that Section 68 (a) did not apply.

However, in the case of *Hiscock* v. *Varick Bank*, 206 U. S. 28, decided in this Honorable Court, and affirming *In re Mertens, et al., supra,* we find that although counsel for appellant therein urged that the provisions of Section 68 (a) should be applied (206 U. S. 34), this Honorable Court, in its decision, did not even mention Section 68 (a), but decided that appellants' contention that the value of the security should be deducted from the claim has no application to cases in which the security is not the property of the bankrupt. See also *In re Keep Shirt Co., supra,* where it was held that Section 57 of the Bankruptcy Act has no application where the security is not the property of the bankrupt.

See also *Gorman* v. *Wright, supra,* frequently cited by the Courts, in which case the bankrupt had endorsed a note and the creditor who held the note also held collateral security of the maker in the form of

certain shares of stock. The lower Court held that the proceeds of the collateral security should be credited against the claim, but the upper Court reversed this conclusion and said, at page 165:

> "* * * The security held by said Gorman was the property of the maker of the note, in which the bankrupt had no interest, and, therefore, under sub-section 23 of Sec. 1 of the Bankruptcy Act of 1898, * * * the claim was properly allowed against the estate of the bankrupt indorser for the full amount due, regardless of said security * * *."

Again on page 165 the Court said:

> "* * * under the bankruptcy law a creditor, to be 'secured', must either hold security against the property of the bankrupt, or be secured by the individual obligation of another who holds such security; and, as it is clearly shown by the record that P. H. Gorman did not come within either of said classes, it must follow that the order requiring the application of the collateral of the principal creditor was treating the claim as secured to that extent, and hence error.
>
> The Court below, in directing that a creditor who has been allowed to prove his claim as an unsecured creditor against the bankrupt indorser must realize and credit the proceeds of collateral securities held by him against the principal debtor before he will be allowed to participate in the distribution of the estate of such indorser, *may have been observing the usual equity rules applicable to the adjustment of similar matters in ordinary proceedings, but in so holding we think that due force and effect was not given to that portion of the Bankruptcy*

Act which defines the two classes of creditors, the 'secured' and the 'unsecured.' We have hereinbefore in effect described the 'secured' debts. All other debts than those so mentioned must be 'unsecured'.

The security held by P. H. Gorman was not the property of the bankrupt, Mathews, and its value is immaterial; for Gorman was entitled not only to prove his entire claim against such bankrupt estate, but also to receive the regular dividends thereon, and then proceed to enforce his claim upon his security. *The equitable rule that a creditor having a lien upon two funds must exhaust that one upon which other creditors have no lien does not apply in cases where it operates to the injury of the party having the double lien, and this rule has, in substance, been made part of the Bankrupt Act.*" (Italics ours.)

In the *Matter of West Point Investment Co., Bankrupts, supra,* to the contention that the bonds put up as collateral by the maker of notes (the indorser was in bankruptcy) should be appraised and sold before the claim was proved, the Court said, at page 579:

"* * * claimants should be permitted to prove their claims *as a proposition of law and equity* (italics ours), although their indebtedness is secured by bonds of the La Grange Lumber & Supply Co., since these bonds are not collateral security *of the bankrupt,* but of the La Grange Lumber & Supply Co., who, as the facts clearly indicate, only served as the third party through whose hands the money passed to satisfy its indebtedness to the West Point Investment Co."

It must be remembered that when the bankrupt sold the property in question to Yavne (R. 3), the bankrupt then received payment for its equity in the property over and above the mortgage, and that the trustee herein, who now stands in the shoes of the bankrupt, although he asks for a credit, has not offered to make the petitioner *whole*, as in equity and good conscience should be done.

It is further respectfully submitted that in the foreclosure sale of the property in question nothing was taken from the bankrupt estate, as the property did not belong to the bankrupt on the date of adjudication.

It is respectfully submitted that petitioner is entitled to prove its claim in *full* and that to reduce the claim to $1,739.94 and pay dividends on that amount only would deprive petitioner of a part of its security and impair the obligation of its contract (the bond). It would certainly be inequitable to allow the claim at that amount only. The payment of dividends even on petitioner's entire claim would probably not give petitioner more than full payment of its claim.

It is respectfully submitted that Section 68 (a) does not apply in the case at bar and that according to law and equity the petitioner's claim should be allowed in full, without any credit for the value of the property.

Respectfully submitted,

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